

**Q2 2022 Tapestry Inc Earnings Call - Final**

FD (Fair Disclosure) Wire

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**Body**

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Presentation

OPERATOR: Good day, and welcome to this Tapestry conference call. Today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn the call over to the Global Head of Investor Relations, Christina Colone.

CHRISTINA COLONE, GLOBAL HEAD OF IR, TAPESTRY, INC.: Good morning. Thank you for joining us. With me today to discuss our second quarter results as well as our strategies and outlook are Joanne Crevoiserat, Tapestry's Chief Executive Officer; and Scott Roe, Tapestry's Chief Financial Officer and Head of Strategy.

Before we begin, we must point out that this conference call will involve certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act. This includes projections for our business in the current or future quarters or fiscal year.

Forward-looking statements are not guarantees, and our actual results may differ materially from those expressed or implied in the forward-looking statements. Please refer to our annual report on Form 10-K, the press release we issued this morning, and our other filings with the Securities and Exchange Commission for a complete list of risks and other important factors that could impact our future results and performance.

Non-GAAP financial measures are included in our comments today and in our presentation slides. In addition, as we continue to anniversary the onset of the COVID-19 pandemic, we will again be providing financial information compared to FY '20 or prepandemic in FY '21, where applicable. For a full reconciliation to corresponding GAAP financial information, please visit our website [www.tapestry.com/investors](http://www.tapestry.com/investors) and then view the earnings release and the presentation posted today.

Now let me outline the speakers and topics for this conference call. Joanne will begin with our second quarter highlights for Tapestry and our brand. Scott will continue with our financial results, capital allocation priorities and outlook going forward. Following that, we will hold a question-and-answer session, where we will be joined by Todd Kahn, CEO and Brand President of Coach. After Q&A, Joanne will conclude with brief closing remarks.

I'd now like to turn it over to Joanne Crevoiserat, Tapestry CEO.

JOANNE C. CREVOISERAT, PRESIDENT, CEO & DIRECTOR, TAPESTRY, INC.: Good morning. Thank you, Christina, and welcome, everyone. We delivered record sales and adjusted earnings in the holiday quarter, highlighted by an inflection at Kate Spade, ongoing momentum at Coach and a return to prepandemic revenue levels at Stuart Weitzman. Importantly, we realized the significant acceleration in sales trends, driving strong double-digit growth over prepandemic levels and well outpacing our expectations across brand.

We took bold and deliberate actions to deliver for our customers and effectively navigated industry-wide challenges to meet increasing demand for our brands. These results are a testament to the significant transformation of our business, the strong consumer backdrop and engagement with our categories, and the ingenuity and agility of our

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teams across the globe. We are a different company than we were just 18 months ago, backed by the strength of our unique brands and the benefits of our multibrand platform.

Now turning to the highlights from the second quarter. We continued to make meaningful progress against the acceleration program by sharpening our focus on the consumer, leveraging data to lead with a digital-first mindset and working with speed and agility. First, we maintained a consumer-centric lens by utilizing our customer data and analytics capabilities to enhance engagement, resulting in improvements to key customer metrics. We acquired nearly 3 million new customers who transacted with our brands across channels in North America, a low double-digit increase compared to the prior year with growth in both stores and online.

This brings total new customer acquisition to over 11 million over the past 18 months. Importantly, in each brand, we're increasing retention rates and reactivating lapsed customers effectively as we continue to prioritize driving customer lifetime value to fuel sustained growth.

Second, we advanced our digital capabilities through significant investments in the channel to improve the customer experience and drive conversion. We realized another quarter of outperformance with sales up approximately 30% versus last year, nearly 3x prepandemic levels. Digital sales represented 1/3 of our total business as customers continued to shop online even as in-store traffic trends improved. Given strong consumer engagement in this channel and the power of our platform, we expect digital to reach \$2 billion in revenue in this fiscal year with further runway ahead.

Third, we again increased global AUR at each of our brands, reflecting the power of our brands, the traction of our compelling product assortment and our innovative marketing. In addition, we've benefited from the infusion of data into our decision-making to streamline our offering and tailor messaging to consumers. This has resulted in lower promotions and higher SKU productivity while also helping to identify opportunities to strategically raise prices to offset inflation.

And fourth, we invested further in our China platform to foster distinctive connections and engagement with Chinese consumers. In the quarter, revenue on the Mainland rose mid-single digits, representing an increase of over 35% compared to fiscal year '20 despite disruption associated with COVID, including travel restrictions, traffic pressure and lockdowns in certain cities.

Greater China revenue rose high single digits in the quarter. Importantly, we continued to resonate with the Chinese consumer globally as sales for this cohort rose low single digits against prepandemic levels.

In the quarter, sales growth in China was fueled by digital as we continue to innovate and meet consumers where they want to shop. As such, we've expanded our presence on social media platforms while maintaining leadership positions on Tmall and TikTok even as new brands have launched on the platform, highlighting our prominence in the market and strong brand engagement, specifically with younger consumers. In fact, we achieved record sales during 11/11 on Tmall's Luxury Pavilion with Coach as the #1 ranked brand in the handbags, luggage and leather goods category and Stuart Weitzman as the #1 ranked footwear brand.

Looking forward, while we anticipate volatility in the near term due to the pandemic, we remain confident that China represents a meaningful long-term opportunity across our brand. This was reinforced by our recent China brand tracking survey results, which showed handbags and small leather goods as a category where consumers intend to spend more over the next 12 months.

I will now touch on second quarter highlights for each of our brands, starting with Coach. We again outperformed expectations, delivering 24% sales growth compared to last year. Revenue trends accelerated on a 2-year basis, increasing 20% above prepandemic level. This strong growth was enabled by the foundational changes we've made to ensure the consumer remains at the forefront of our strategy. As a result, Coach achieved its highest quarter revenue and profitability in nearly 10 years. The brand continues to gain traction with consumers globally across categories and genders, further increasing our confidence in the runway ahead.

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During the quarter, Coach made progress against its strategic initiatives. First, we remain focused on building iconic families to create a foundation for our product pipeline in future seasons. Our core assortment, notably the Tabby, Willow and Field continue to drive our performance. At the same time, newly launched styles, including the Studio bag, and reinvigorated icons, such as the Rogue, resonated with our customer base.

Second, we further infused data into our decision-making to more effectively address the functional and emotional needs of our clients. This enabled a significant pullback in promotions and drove full-price selling, resulting in an increase in global handbag AUR. In North America, handbag AUR rose low double digits, marking the region's 11th consecutive quarter of gain. Our momentum and the customers' response to the style and craftsmanship of our product reinforces Coach's pricing power and the further opportunity to increase prices to offset inflationary cost pressures.

Third, we emphasize the brand's values through approachable messaging, highlighted by our inclusive holiday campaign. In addition, we connected with all audiences through the authentic recreation of Jennifer Lopez's iconic "All I Have" music video, which resulted in strong social engagement.

Our marketing initiatives were rounded out by the unique storytelling moments created by our successful Ski capsule, including popup cabins at Rockefeller Center, a custom-branded virtual game and our first foray into the NFT world featuring characters from the collection, which were claimed in seconds.

Overall, these actions helped to drive strong customer metrics, including the acquisition of over 1.5 million new customers transacting in North America. At the same time, purchase frequency again rose, and we reactivated lapsed customers at an increasing rate.

Fourth, we again drove strong revenue growth in the digital channel, which rose over 30% compared to last year and has nearly quadrupled since fiscal year '20. We maintained this momentum even as store trends improved, underscoring the long-term opportunity for our online business.

Fifth, we delivered mid-single-digit sales growth in China or an increase of nearly 45% against prepandemic levels. This improvement was led by outperformance in digital. At the same time, we continued to invest in our physical presence.

In keeping with our focus on growing the brand with the emerging middle class, we're adding approximately 10 new Coach stores in the region this year on a net basis, primarily in Tier 3 and 4 cities. We're also renovating key storefronts and expanding our footprints in nontraditional locations to build awareness, particularly with younger consumers.

Sixth and finally, we drove double-digit growth in our men's business with notable success in our Horse & Carriage pattern. We believe men has runway in bags and small leathergoods as well as in broader lifestyle categories, increasing our conviction in reaching \$1 billion in revenue at high margins over the planning horizon.

In summary, we're combining Coach's iconic history of quality and craftsmanship with new and innovative initiatives to engage with consumers. The continued outperformance of the brand is a direct reflection of the advantages of the Tapestry platform, the benefits of the strategic investments we're making in marketing and our ability to meet the consumer where they want to shop. We're driving sustainable (inaudible) Coach approaching \$5 billion in sales in fiscal year '22 while maintaining exceptional margins.

Now moving to Kate Spade. Before I turn to the details of the second quarter, I'd like to take a step back to acknowledge the significant transformation and tangible improvements the team has made through the acceleration program.

Over the last 18 months, we've returned Kate Spade to the brand our customers know and love. We've rebuilt our product foundation through the introduction and amplification of brand codes, which will serve as the platform for future icons. At the same time, we're maintaining a consumer-centric lens and infusing data into assortment planning and marketing.

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In North America, we acquired nearly 5 million new customers and have improved brand awareness. We've also reactivated over 2 million customers during this time frame. In addition, we increased overall digital sales penetration to over 35% as of the most recent quarter as we focus on meeting the customer where they want to shop.

And in keeping with the progress we've made to deliver great products, we've grown the brand's global handbag AUR highlighting pricing power for the future. Our work has fueled increasing momentum, giving us further confidence in the long-term opportunity for meaningful sales and market share growth.

Moving to our second quarter. Kate Spade sales grew 33% compared to last year. Importantly, we drove a significant inflection against prepandemic levels and realized an 18-point sequential acceleration. At the same time, the brand delivered operating margin expansion ahead of both prior year and prepandemic level.

These results were fueled by the successful execution of our strategic priorities. First, we maintained a consumer-centric approach, resulting in approximately 1.3 million new customers purchasing with the brand across North America direct channel. At the same time, we continue to drive strong double-digit growth in both existing and reactivated customers by utilizing data to gain a deeper understanding of customer preferences and purchase drivers.

Second, we amplified key platforms as we continued to build and innovate our core product offering, notably our Knott and spade flower jacquard again outperformed expectations. In addition, newly introduced core styles resonated with the consumer, including our Carlyle family in a houndstooth pattern, which brought in a new and younger customer. Importantly, the strong performance of the core offering as well as deliberate actions to decrease promotional activity resulted in low double-digit global handbag AUR growth.

Third, we drove brand heat through activity centered around increasing engagement with the consumer while reinforcing our brand values to surprise and delight customers. This included new and exciting experiential initiatives, such as opening a disco truck in Downtown Manhattan, offering an exclusive jacquard handbag at a pop-up in Tokyo, and wrapping some of London's cabs in our signature spade flower.

Further, in keeping with the brand heritage, we continue to invest in novelty platforms to maximize our emotional connection with shoppers. The sequin-embellished slice pizza bag at an AUR of over \$300 was a top novelty performer, and a hit across our social media accounts. Overall, these activities to increase brand heat are paying off with growing brand awareness per our most recent U.S. brand tracking survey.

Fourth, we maximized our lifestyle positioning through a focused assortment, including occasion options across ready-to-wear footwear and jewelry that were embellished with emotional details such as pearls and rhinestone bows. Overall, these categories outperformed expectations and helped to boost customer acquisition and engagement as lifestyle remains an important driver of purchase frequency.

Finally, we're building on the brand's already strong digital presence. We've continued to test and learn new ways to foster consumer engagement, such as the infusion of shoppable content through key social media platforms. Our innovative online approach backed by the passionate Kate Spade community helped to drive approximately 30% revenue growth in the channel compared to last year or double prepandemic level.

Over the past year, we've rebuilt the brand foundation. These fundamental adjustments are taking hold and unlocking the next phase of growth for Kate Spade. We're continuing to lean into our iconic roots, infusing our recently introduced brand codes and delivering strong marketing aligned with our product and values. We are incredibly excited for the opportunity ahead and remain confident in our ability to achieve \$2 billion in revenue and high-teens operating margins over the planning horizon.

Turning to Stuart Weitzman. The brand drove significant trend improvements in the holiday quarter, highlighted by 37% revenue growth compared to last year and a return to prepandemic sales levels. In addition, we delivered improving operating profit with operating margin expanding over 250 basis points.

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We continued to advance our overall growth strategies in the second quarter. First and importantly, the Stuart Weitzman team delivered the brand's highest quarter of operating income since fiscal year '18. This progress was fueled by the strategic actions we've taken through the acceleration program, notably optimizing our fleet globally, improving our digital foundation and reestablishing our presence with wholesale partners.

Second, we remain focused on digital in China, areas that represent significant long-term growth opportunities. In the quarter, digital sales rose over 35%, representing an increase of approximately 70% compared to 2 years ago at attractive margins. For Mainland China, we delivered growth on both a 1- and 2-year basis.

Third, we maintained a consumer-centric strategy by infusing data analytics into assortment planning and capitalizing on market shifts to buy now, wear now styles and dress and occasion wear. This drove the recruitment of new customers at an increasing rate, while continuing to reengage and reactivate clients.

Fourth, we drove brand heat by sparking desire through our product assortment backed by engaging marketing, which featured Kate Hudson for the holiday campaign. We built upon our authority in boots and booties with outperformance in the Norah and Stuart. We also infused newness into our icons, including updated constructions of the LIFT and the introduction of our NUDISTCURVE.

Our compelling assortment, coupled with higher full price sell-throughs and a reduction in promotional activity drove our second consecutive quarter of AUR growth. Going forward, we see continued opportunity to increase prices while maintaining our positioning within the overall market.

And fifth, the brand continued to regain momentum in the wholesale channel, notably with key domestic full-price partners. Overall, we're making continued progress at Stuart Weitzman and remain on track to drive strong revenue growth with a return to profitability this fiscal year.

In closing, our strong holiday results across each of our brands support the higher revenue and earnings outlook provided today. Importantly, the outperformance we've delivered is a direct reflection of our consumer-centric strategy as we continue to grow our data and consumer insights capabilities to enable increasingly powerful customer engagement. Our momentum also highlights the incredible execution of our team and the agility of our platform as we've successfully navigated the volatile backdrop.

We're continuing to offer compelling and innovative products, underscored by the increased traction and pricing power of each of our brands. I'm confident in the long-term potential of our multibrand portfolio and look forward to sharing our continued progress as we move forward.

With that, I'll turn it over to Scott, who will discuss our financial results, capital deployment priorities and fiscal '22 outlook. Scott?

SCOTT A. ROE, CFO & HEAD OF STRATEGY, TAPESTRY, INC.: Thanks, Joanne, and good morning, everyone. We delivered another quarter of high-quality results, including sales outpacing last year, prepandemic levels and expectations despite a difficult backdrop. At the same time, we utilized our strong free cash flow to return over \$550 million to shareholders in the quarter through a combination of share repurchases and dividends.

Through the acceleration program, we're a fundamentally different company as evidenced by our better use of data, higher digital penetration and stronger margins compared to prepandemic levels. We're increasingly building momentum across our portfolio of brands.

Turning now to the details of the second quarter. Revenue increased 27% compared to prior year, outpacing expectations at each brand. Against prepandemic level, sales rose 18%, a 9-point sequential acceleration driven by better trends in stores along with continued strength in the digital channel. By region, North America delivered over 35% revenue growth compared to last year. And the region accelerated to 25% growth on a 2-year basis amid a strong consumer backdrop with increasing demand for all of our brands.

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Sales in Greater China rose high single digits, including a mid-single-digit increase in Mainland China. Compared to 2 years ago, the region grew nearly 35%. Trends in both Europe and the balance of Asia improved versus the prior quarter on a 1-year basis, though remain below prepandemic levels largely due to the lack of tourist inflows and COVID resurgences.

Moving down the P&L. As anticipated, gross margin contracted in the quarter, reflecting our early and deliberate actions to invest in incremental freight to maintain product flow. In spite of a 320 basis point headwind from these freight investments, the gross margin was still nearly 150 basis points ahead of where we were just 2 years ago. This is a testament to the better use of data analytics to improve assortment planning and marketing messaging, driving lower promotional activity, increased SKU productivity, and higher full-price sell-through. SG&A growth slightly outpaced the sales increase as anticipated given last year's unusual compares associated with the pandemic, including wage subsidies and rent concessions as well as a gain from the deferred purchase price of the Kate Spade China joint venture.

Excluding these nonrecurring items in the prior year, we drove leverage in the business while making continued investments in digital, marketing and talent. So taken together, operating income grew double digits in each brand. And while operating margin was impacted by freight, the quarter was still nearly 2 points ahead of where we were just 2 years ago. Earnings per diluted share for the quarter was \$1.33, an increase of 15% compared to the prior year and over 20% versus FY '20.

Now turning to our balance sheet and cash flows. We ended the quarter in a strong position with \$1.65 billion in cash and investments and total borrowings of \$1.6 billion. Inventory at quarter end was 19% above prior year, including a significant increase in in-transits. While our actions to aggressively secure goods positioned us well for the holiday period, top line sales in excess of our expectations, notably at Kate Spade, resulted in lower-than-projected inventory balances.

Touching on capital allocation and cash management. Based on the strong results of our second quarter, significant free cash flow generation, robust balance sheet and our outlook for growth, we now expect to return over \$1.5 billion to shareholders in fiscal '22, an increase from the prior outlook of \$1.25 billion. We now anticipate the repurchase of \$1.25 billion in common stock, which includes \$750 million bought back through Q2. In addition, our shareholder return plans continue to assume approximately \$270 million through our dividend program.

Our capital deployment plans underscore our commitment to our shareholders and our confidence in the momentum of our business. Overall, our capital allocation priorities remain unchanged. First, we're investing in the business to drive long-term profitable growth; and second, we're returning capital to shareholders through dividends and share repurchases.

Separately, during the quarter, we completed a \$500 million tender offer on our notes due in 2025 and 2027, funded by a \$500 million 2032 bond offering, a leverage-neutral transaction that allowed for effective debt maturity management and a modest benefit to our interest expense. In addition, we still intend to repay our July 2022 bonds totaling \$400 million by the end of this fiscal year.

Now turning to our fiscal '22 outlook. Before we move into the details of our guidance, I'll touch on the current external environment. Across the world, the backdrop continues to be volatile. Consumer demand in the United States remains high, while near-term headwinds associated with the pandemic exist in China, which I'll expand upon shortly.

Further, supply chain constraints persist throughout the industry. We're continuing to act boldly to mitigate these headwinds and deliver for our customers. Please note that all growth rates compared to prior year are on a comparable 52-week basis excluding the impact of our 53rd week last year.

We now expect revenue to be approximately \$6.75 billion, which would mark a record for the company. This represents an increase of nearly 20% compared to fiscal '21 with strong double-digit growth at each brand. Our guidance contemplates ongoing strong momentum in North America in the second half, which is helping to offset

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the expected near-term COVID-related disruptions in China. This is proof of the benefits of our globally diversified platform.

Our guidance also incorporates lower-than-expected on-hand inventory due to the revenue outperformance in the first half as well as higher levels of in-transits. These longer lead times from ongoing supply chain disruptions are expected to limit our ability to chase stronger underlying demand in the second half of the year, specifically in Q3.

We continue to expect modest operating margin expansion for the fiscal year, maintaining our gross margin and SG&A rate expectations. As previously shared, we expect gross margin to contract modestly due to incremental cost pressures associated with freight. The pressure is now expected to be approximately \$170 million in the fiscal year.

Excluding this impact of 250 basis points, underlying gross margin continues to expand through lower discounting and improved SKU productivity. In addition, we're capitalizing on the pricing power exhibited by each of our brands by increasing prices selectively going forward. In addition, modest SG&A leverage is anticipated for the fiscal year. We continue to expect about \$300 million in structural gross run rate expense savings as a result of the acceleration program.

We're committed to reinvesting in the business to fuel long-term growth. Net interest expense for the year is now anticipated to be between \$60 million and \$65 million. In addition, our guidance contemplates a fiscal year tax rate of 18.5%, assuming a continuation of current tax laws.

We are now expecting weighted average diluted share count to be in the area of 274 million shares. This lower guide largely reflects our more aggressive posture in the second quarter along with the previously mentioned \$250 million increase to the buyback expectation for the year. So taken together, we now expect EPS to be \$3.60 to \$3.65 above our prior guidance of \$3.45 to \$3.50. Finally, we now anticipate CapEx to be about \$200 million for the year.

Turning to the second half, we continue to contemplate double-digit revenue, operating income and EPS growth with particular strength in the fourth quarter. So to provide some more guardrails on Q3 specifically, revenue is expected to increase low double digits, which contemplates the inventory constraints previously mentioned. While these pressures are being realized across the portfolio, we anticipate an outsized financial impact on our smaller brands, given their relative size.

Looking at the bottom line, third quarter operating margin is expected to contract largely due to incremental freight expense in the area of \$55 million as well as increases in SG&A primarily, due to marketing investments. In addition, while we're continuing to incorporate a 50 basis point benefit to gross margin from the reinstatement of GSP for the fiscal year, we're now reflecting the positive impact in the fourth quarter. Overall, EPS is expected to decline approximately 20% in the third quarter, an increase over 60% in the fourth quarter, which has been contemplated in today's higher outlook for the year.

So in closing, we're further leveraging the benefits of the acceleration program and our transformed business model, evidenced by increasing momentum at each of our brands. Our strong holiday results underscore our confidence in the benefits of our multi-brand platform and direct-to-consumer business model, which supported the increase in the fiscal year outlook. In addition, we're generating significant free cash flow, and now plan to return over \$1.5 billion to shareholders in this fiscal year alone. Overall, we remain confident in our long-term ability to drive continued revenue and operating income gains.

I'd now like to open it up for your questions.

## Questions and Answers

OPERATOR: (Operator Instructions) We'll take our first question today from Bob Drbul with Guggenheim.

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ROBERT SCOTT DRBUL, SENIOR MD, GUGGENHEIM SECURITIES, LLC, RESEARCH DIVISION: I guess, Joanne, can you elaborate a little bit more on the inflection that you're seeing at Kate Spade? And I guess maybe if you could just give us an update in terms of like where you think this brand can go over the longer term, either both on top line but also operating margin, profitability?

JOANNE C. CREVOISERAT: Certainly, Bob. We delivered standout results and a significant inflection in Kate Spade in the second quarter. That was driven by product, people and our focus on the consumer. And Q2 has strengthened our confidence in the long-term opportunity we see to build Kate Spade to be a \$2 billion brand. And I do want to recognize the team for the work over the past 18 months. They've leveraged our Tapestry Platform and the acceleration program to rebuild the foundation of the brand, returning Kate Spade to the brand our customers love.

And just a few highlights on the second quarter. Sales growth of 33% in the second quarter, 16% above prepandemic levels. That was an 18-point sequential improvement, so a significant inflection. And we're doing that with stronger operating margins ahead of both last year and prepandemic levels.

We're continuing to build on the digital strength in the brand with 30% growth there, nearly double prepandemic level. We're acquiring new customers, 1.3 million new customers in the quarter, and we're reactivating -- importantly, reactivating lapsed customers back to the brand. And also importantly, we saw low double-digit increase in global handbag AUR, which shows the power of the product offering that we're building.

The team has been focused on building and amplifying key platforms. We've called out the Knott and spade flower, which continue to perform, and new styles like the Carlyle that are bringing in new customers. These are resonating, and we're seeing higher full-price selling across our assortments.

And I would also add, importantly, we're also seeing growing brand awareness in our consumer research. So a lot to be excited about at Kate Spade. Kate Spade has a unique position in the market, and we are confident in the ability to achieve \$2 billion in revenue at high-teens margins over our planning horizon.

OPERATOR: The next question comes from Ike Boruchow with Wells Fargo.

IRWIN BERNARD BORUCHOW, MD AND SENIOR SPECIALTY RETAIL ANALYST, WELLS FARGO SECURITIES, LLC, RESEARCH DIVISION: Scott, maybe for you, just on the inventory dynamics. Is it possible to give us a little bit more color on the inventory shortfall this quarter? What exactly is the revenue headwind to the total business and specifically to Kate Spade in 3Q just because it's important, I think, for us to understand the trajectory of that brand because it looks like you guys are making some big improvements there. And then are you -- in your forecast, is there anything that you're expecting these headwinds to kind of linger into the fourth quarter?

JOANNE C. CREVOISERAT: Scott, I think you're on mute. Let me -- you got it?

SCOTT A. ROE: I'm not on mute. Can you hear me?

JOANNE C. CREVOISERAT: Yes, we can hear you now.

SCOTT A. ROE: Okay. I'm sure that was my error. Sorry. Yes. So hey, this is a good story, right? We took bold and early actions from an inventory standpoint to position ourselves well for holiday. And as you can see by the strong quarter we had, it worked, and -- particularly in Kate. So the message here that we were trying to convey is that we sold through a lot of inventory, and we wish we had a little more because the demand is really strong and continues into the third quarter. So this is going to put some pressure on our ability to chase the demand in the short term. But over time, we've seen that our production is back in line. We talked about that last quarter. We still have some issues on the logistics side, elongated lead times. So the message here is that, first of all, the demand is strong. We've had a really strong quarter. We wish we had a little more inventory, particularly in Kate Spade, and that's going to put a little hamper on our ability to chase that strong demand, but we'll be back in shape by the end of the year, and we'll see that this is not going to be a lingering issue from our standpoint.

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The other thing I'd just briefly mention, as we brought in this inventory, it had a cost. We talked about that. That's not new, right? So that cost is -- you see it in our gross margin in the short term. Importantly, though, because our flow of inventory is now back to approaching normal levels, we significantly moderated the amount of air freight and expedited freight on a go-forward basis. So that's largely behind us. It'll take a while for that to work its way through the P&L, and we'll see some of those impacts in the third quarter. But on an ongoing basis, we've significantly curtailed the amount of excess freight to get that inventory back in shape.

IRWIN BERNARD BORUCHOW: Scott, are you able to quantify the headwinds at Kate Spade specifically in the third quarter?

SCOTT A. ROE: Yes. We haven't put a number on that. Just know that the demand is stronger than our ability to supply it in the short term, and we will see some moderation in the third quarter in the growth rate at Kate. That is not a reflection of the underlying demand or the strength of the brand. It's more of a supply/demand match in the short term.

JOANNE C. CREVOISERAT: Yes. And I'll add to that, Ike, that our outlook raised our sales expectations for the year. We still expect double-digit increases in the back half of the year and strong double digits across the board across brands for the year in '22, delivering record sales levels at \$6.75 billion so continue to expect top line to perform.

OPERATOR: We'll go now to Erinn Murphy with Piper Sandler.

ERINN ELISABETH MURPHY, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: My question is around digital. It has just continued to be a really strong focal point. And so 2 parts. As you think about the \$2 billion guide for digital this year, how does that break down across concept? And then longer term, has that -- as digital gets bigger, has that led you to reevaluate poor fleet from here, either in outlet or full price?

JOANNE C. CREVOISERAT: Yes. We have fundamentally transformed our business to strengthen our engagement with the consumer in this channel, and you can see that in our results. We are meeting our customers where they choose to engage and shop. And that's really been delivering results. We've invested in capabilities, including in talent to power the work here and drive better consumer experiences across our digital platforms. As you mentioned, we're approaching \$2 billion in business. We reached 1/3 of our business in the holiday quarter, which is triple prepandemic level. So seeing a lot of traction here, and we continue to see new customer growth in these channels. So we feel great about the growth both from the revenue standpoint but also from the customer profile, the new customers, the younger customers that we're increasingly attracting to our brands.

And we're also seeing this digital business as accretive to our margins as digital margins are higher than the respective brick-and-mortar. So that \$2 billion represents a margin benefit to us but also represents an opportunity because, at \$2 billion, it's less than 1/3 of our business on an annualized basis, and we think it can go higher from here. So we feel very optimistic about our digital business and continue to invest in those capabilities.

And then to your question about stores, we also believe that stores represent an important touch point for our brands. And consumers are shopping across channels. We did see improvement in store trends this quarter. At the same time, we continued to deliver strong growth in digital. So as customer shopping behaviors are changing, we're investing behind those experiences and those omnichannel experiences that make that a great touch point for our customers, and it's an important touch point for our brand. We have been focused on driving higher productivity and profitability across our store fleet. And even though our traffic levels in store business overall hasn't exceeded prepandemic levels, our margins in our store fleet have exceeded prepandemic levels. So we've done the work to ensure we're driving more profitability and more productivity out of our store fleet, and we continue to invest in great experiences for our consumers across all channels.

OPERATOR: The next question comes from Lorraine Hutchinson with Bank of America.

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LORRAINE CORRINE MAIKIS HUTCHINSON, MD IN EQUITY RESEARCH, BOFA SECURITIES, RESEARCH DIVISION: Can you talk to the current environment in China? And then from a longer-term perspective, how big of a driver is China in Kate achieving its \$2 billion revenue goal?

JOANNE C. CREVOISERAT: Well, let me start with China, and then I'll touch on the opportunity for Kate, but we did deliver growth in China in the second quarter on both a 1- and a 2-year basis. And we remain confident in the long-term potential that market represents. We see lots of runway ahead in that market. In Q2, we delivered growth 35% ahead of prepandemic levels, and we delivered growth with Chinese consumers globally. And that's been fueled by digital, significant innovation on existing and new platforms. And we see strong engagement with -- particularly with the younger consumer in the market. So continued innovation, strong business, continued growth, fueled by digital in the market.

We do expect some COVID-related pressure in the near term. We're seeing pockets of COVID pressure now, and we expect pressure in the near term, including some of the travel restrictions and lockdowns we mentioned in certain cities. But we continue to believe that China represents that compelling long-term growth opportunity for Tapestry in all of our brands. And a couple of data points. The Chinese consumer has proven to be incredibly resilient throughout this pandemic. And the research that we've done in the market indicates strong brand affinity with our brand. We delivered record sales with the #1 ranking on Tmall for both Coach and Stuart Weitzman in their respective categories. We also see strong purchase intent in our category over the next 12 months, and our brands are well positioned. We're targeting the fast-growing and emerging middle class, and we're executing strategies to drive sustainable growth. And we see that opportunity across all brands.

I would say Kate Spade right now is very small in China. Our focus has been on the North America and Japan markets, the core markets for Kate Spade. And as we get that brand moving, we see opportunity to drive growth in China in the future. But to give a little more color -- I may toss it to Todd to give a little more color about what we're seeing in China with the Coach brand, where we're having -- continued to have success.

TODD KAHN, CEO & BRAND PRESIDENT OF COACH, TAPESTRY, INC.: Thanks, Joanne. As most of you know, the Coach brand has been in China for over 20 years. We have deep, deep roots in the country. And in our recent brand perception study, 2 things were very noteworthy. One, the majority of the Coach customers in China have a positive economic outlook for the next 12 months. And that gives us a lot of energy around our clients and our customers there.

Two, the Coach brand is a beloved brand that successfully competes with traditional European luxury brands. And we love that positioning. And we're going to continue to invest and grow in China. For example, last summer, we held a major fashion show in Shanghai showcasing our winter collection. That showcase led to the sales of the Ski capsule that we showed and sold in our stores in the second quarter. We will return this summer with another winter show in China, continuing to build on the momentum and really focusing on both the emotional and functional needs of our Chinese clients. So again, both our mid- and long-term expectations and growth in China are very robust, and we're really excited about what the Coach brand is going to deliver under the Tapestry platform in that area.

OPERATOR: We'll go now to Oliver Chen with Cowen.

OLIVER CHEN, MD & SENIOR EQUITY RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: The average unit retail increases of the Coach brand have been really impressive. But what's ahead with maintaining that and anniversary-ing that in terms of sustaining that momentum? And as a follow-up, NFTs and the Metaverse have been increasingly embraced by luxury brands. What are your thoughts on the strategy there and how that may be executed, as well as, this is a different question, ESG and supply chain, just key priorities that you have for ESG and supply chain as well.

JOANNE C. CREVOISERAT: Thanks, Oliver. There's a lot there. I'll start with pricing and move to the Metaverse and then to ESG. So on pricing, across brands, we represent compelling value in the market. We deliver beautiful quality product at great prices. We do see the market moving higher, and we've had success in driving AUR. We

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see AUR as an opportunity across our brands. We saw that in the second quarter where we drove AUR higher across all of our brands. And we've had sustainable growth at Coach, which is notable. And we're driving AUR increases through product innovation with this disciplined promotional activity and really through our transformation efforts that I've called out.

And consumers continue to recognize the value we're delivering. We do see further runway. We think it's sustainable. We see runway to leverage price increases to offset inflation while maintaining our market positioning and delivering compelling value for our customers, which is our overarching goal. And we talked about the transformation efforts and the sustainability of these results, but we are using data to improve our assortment planning. We're seeing increased SKU productivity, lower discounting. We're not relying on promotions. We're seeing the pricing power happen across brands. Maybe I'll toss it to Todd to talk a little bit about what you're seeing at Coach, where we've had an amazing track record of success but continue to see runway, and then I'll pick up the ESG and Metaverse question. Todd?

TODD KAHN: Great. Thank you, Joanne. Oliver, you know Coach at its best balances logic and magic. And the Tapestry platform has enhanced the logic side, particularly with our digital center of excellence and our consumer insight work. On the magic side, over the last 2 years, we have created an environment where our creative team, led by Stuart Vevers, can thrive. This combination has resulted in 11 quarters of increased handbag AUR in North America, a second quarter resulting in the highest revenue and profitability in 10 years, a sustainable top line approaching \$5 billion in this fiscal year, substantially greater SKU productivity, over 1.5 million new customers transacting with the brand in North America just this last quarter, meaningful growth in men's ready-to-wear and footwear and all men's categories. Finally, our inclusive, authentic and fun storytelling in our marketing.

These are foundational changes for our brand. And what this allows us to do is to continue to push and get priced in our product. And when I've been asked over and over again in many quarters now about how much more room is there in AUR. I look at where the Coach brand sits today relative to traditional European luxury. And the white space between where we transact and where traditional European luxury transact is at the greatest delta in 20 years. That gives us a lot of confidence and a lot of room to grow our price positioning. So I'm very optimistic about our future.

I know Joanne will talk about sustainability. On the NFT, we dipped our toes in the water last quarter. We are going to look at it. I think I like selling physical real product, and our consumers like the touch and feel, but I do think that's an opportunity to explore as we really get closer, particularly to a younger consumer. So you'll see more of that over time. And then I'll kick it back to Joanne to talk about sustainability.

JOANNE C. CREVOISERAT: Yes, and I'll just add, the work we're doing with NFTs right now is an example of how we think about innovation. We're always testing new ways to engage with consumers. We're testing and learning how they engage with NFTs, how it drives consumer loyalty. So we're experimenting, and we'll see where the customer takes it as we learn more about NFTs.

And on ESG, I appreciate the question. ESG is important to our company and all of our brands. We have a program called Our Social Fabric that's been part of the fabric of our company, and it's focused on 3 pillars: it's focused on our people, our planet and our communities. And we continue to drive progress -- we have stated goals, and we continue to drive progress behind goals in all of those categories. I am pleased to report that we just released our corporate responsibility report just published. I think it goes into a lot of detail at some of the progress we've been making across all 3.

I'll just hit a couple of highlights. We announced a bold commitment to tie 10% of our leadership incentive comp to our progress on EI&D. We are committed to making progress on these objectives, and we are making progress. I know you know we established \$50 million Tapestry Foundation to support some of those initiatives, and we recently launched a founding partner with FIT in their Social Justice Center to also improve EI&D in our industry. So we're focused on in our company but also in our industry.

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On the planet, we've recently announced a partnership with Savory Institute on regenerative leather, supporting our biodiversity objectives. We signed on to the science-based target initiatives to -- with a goal of net zero by 2050 at the latest. And we're making progress on our renewable energy goals as well as our sourcing and traceability. So that continues to be a strong focus of the company.

And then within our communities, I'm very proud of the volunteer work and the service that we are doing. All of our associates are super engaged. In this, we provided 1 paid volunteer day for our associates to get involved with their communities. It was an objective of meeting our \$100,000 volunteer -- 100,000 volunteer service hour goal, and we are far along, and it's driving a lot of pride across our teams. Our teams really appreciate the fact that we support their efforts to focus on the community, and they're proud to work for a company and be working towards not only the improvement of our business, but something much bigger than that. So ESG is very important for our company, and we're making progress.

OPERATOR: (Operator Instructions) We'll go next to Mark Altschwager with Baird.

MARK R. ALTSCHWAGER, SENIOR RESEARCH ANALYST, ROBERT W. BAIRD & CO. INCORPORATED, RESEARCH DIVISION: I wanted to follow up on the digital front. You've been accelerating your investments there, and I was hoping you could just unpack it a little bit. I guess, first, I think part of that is marketing, which clearly appears to be contributing to the momentum today. And I think you're also investing in teams and capabilities, which might still be in the earlier innings. So I guess I'm curious, one, what were the learnings from the investments over the holiday quarter? I guess which channels are you seeing the greatest success? And two, just kind of medium term here, how should we think about the leverage point on SG&A as you continue leaning into digital?

JOANNE C. CREVOISERAT: So thanks, Mark. We have seen a lot of success in digital, and we're seeing strong returns on the investments we are making. There is a technology component to this, and it combines both our digital and our data and analytics capabilities. We have a strong technology foundation that allows us to adopt new technologies and new innovations quickly. So embedding data and analytics into our processes in a more robust way is helping drive conversion. It's helping drive our marketing as well, the platform and foundation we're investing in, and that's helping us with performance, and we've seen improvement.

This holiday quarter, our digital business grew 30%, I call it strength on strength, but we did that, and we delivered a much better experience for our consumers. And we saw our customer satisfaction scores increase significantly across the holiday quarter with the changes we're making. So it's impacting the experience. It's impacting our results and conversion, but I also -- the talent that we're building and, to your point, those investments are increasingly in talent and having the teams that are helping drive this innovation, and they're doing great work. I would say innovation is the final piece that is powering our business. And we're very focused on moving with speed to be where our customers are.

And you can see the innovation we're delivering on those spaces being on new platforms and innovating quickly. We were -- in China, we were the first fashion brand to be -- to have a commercial site on TikTok. We remain #1 on TikTok and Tmall there. We have shoppable content across social media platforms. And even the NFTs that we talked about earlier is a sign of how we think about innovation, testing and learning and moving quickly to be with our customer and stay close to our customer. So that is the focus of the investments, and we're seeing strong returns.

SCOTT A. ROE: Yes, Mark, maybe I'll just build to and part of your question was around leverage and how we see that. I just, first of all, say the power of these platforms is really impressive, and you heard Todd mention how the logic side of the business is really powering all of our brands, and I think it's obvious in the results that you're seeing, and I can tell you as someone who's relatively new to the story, seeing this company go from a technology deficit to technology really driving the business in a really short period of time through the acceleration program, it is really, really impressive and encouraging.

And I'll just remind you, in the prepared remarks, I talked about \$300 million of structural run rate savings that came through the acceleration program over the last couple years. That's not really about saving money to save money.

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That's reallocating money into our digital and consumer data experience and, again, building those platforms which have leverage. So that's how we can have significant investments in some of the, what I would argue, the points of difference that are really driving our business. And at the same time, having leverage in other parts of the SG&A structure allow us to continue to grow our operating margins over time. So that's kind of the flywheel or the secret sauce here, I think as you look at this transformed business model that unlocks future growth.

OPERATOR: Our next question comes from Michael Binetti with Credit Suisse.

MICHAEL CHARLES BINETTI, RESEARCH ANALYST, CRÉDIT SUISSE AG, RESEARCH DIVISION: Congrats. A lot of nice stuff to look at here this quarter. Can you just -- can we zero in maybe on the Coach gross margin for just a second here. I want -- maybe the 2-year trend we were looking at slowed a little bit from first quarter, but any components there between -- I know you gave us freight for the whole company, but freight for that brand versus the impact of the AUR work you're doing. Just so we understand a little bit better what impacts there are durable versus transitory as we roll over the next few quarters here. And then Scott, wouldn't be a conversation with you and I unless we talked about the SG&A for the company. It looks like -- hope you're doing well, Scott.

SCOTT A. ROE: You're consistent, my friend.

MICHAEL CHARLES BINETTI: Yes. I guess just a bit of a dovetail off Mark's question, as we look at some of the flow-through on the revenue upside in this quarter versus the plan, the really nice revenue upside, the SG&A seems to -- the flow-through rate looks a little bit more like what we saw last fiscal year than last fiscal quarter. Maybe just how to think about flow-through on SG&A to the extent that you do find upside in the revenues in the next couple quarters here?

SCOTT A. ROE: Yes. Maybe I'll start and then Todd maybe will build a little bit as you think about margins and AURs. But listen, in terms of the -- I think your question was around what we're seeing in freight on Coach and the impact on margins. Really not a big difference overall. The overall guidance I gave you, Michael, is not so different by brand in terms of how it's allocating. So as you try to think about the ongoing margin structure, there's nothing that I would call out that's particularly unique one brand to the other. We took these bold actions pretty much across the board because a lot of the issues we were seeing were universal in our supply chain.

And again, I think you see the results in Q2, some of those actions that we've made. Remember my earlier comments, though, in terms -- we did the expedited freight and the air freight for a very specific reason. We saw Vietnam, which at the time was -- about 40% of our production was down, and we had a hole in our supply that we made up for through those expedited, I'll just say, airfreight actions. Again, to repeat, we now see the flow more normalized. That's largely in the rearview mirror. It'll take a little while to work through the P&L because it attaches to the inventory. And as that inventory sells through, you'll start to see that, particularly in the third quarter. But on an ongoing basis, we do see elevated ocean rates, but a lot of this expedited freight is going to go back to more normal levels. And already that's happened. It just takes a while to go through the P&L. And we also have pricing action on an ongoing basis. I don't know, Todd, if you want to build on that, what you're seeing in the Coach brand.

TODD KAHN: Sure, Scott. Thank you. As you've seen, our AUR have grown each and every quarter. And part of what allows us to do that is the focus on our iconic product and really elongating the families of product in our offering. And that has provided us the ability to discount less to raise prices. So I believe, over the next year, you'll continue to see us do more of that. You'll continue to see us absorb any inflation through pricing. Obviously, you can't do that in 1 quarter when you're hit with freight. And I think the reason Coach is in perhaps maybe a slightly better inventory position than our sister company is not that our merchants don't want the newest, greatest product as well, it's just we've been on the journey a little longer on developing iconic product that allows us to stay in a slightly better inventory position. So I feel very good about our pricing power. I feel very good about our ability to absorb the input cost, and I will enjoy not erring goods in, in the future to the same level obviously.

SCOTT A. ROE: And Michael, let me just take your SG&A question real quick, too. I would say, listen, there's some timing quarter-by-quarter as we think about different marketing actions, top of the funnel actions. I would just point you to the big picture here, right? We have taken up our top and bottom line guidance for the year. We have

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maintained our gross margin and SG&A shaping, and we still intend to increase our operating margin for the full year. So is there some timing quarter-by-quarter? Yes. I think the bigger picture here is we had a strong quarter, and we've taken up our guidance, and we still maintain the fundamental metrics that we talked about even despite a volatile backdrop, as I mentioned before. So I think that, from my standpoint, is the big picture here.

OPERATOR: We'll go now to Brooke Roach with Goldman Sachs.

BROOKE SILER ROACH, RESEARCH ANALYST, GOLDMAN SACHS GROUP, INC., RESEARCH DIVISION: Joanne, I would like to dive a little bit deeper into the 3 million new customers across channels that you acquired in North America this quarter, which is a strong result against a tougher year-on-year compare. Can you talk a little bit more about what specifically you're seeing that are driving those new customer acquisitions and the sequential improvement you saw in this quarter? And then on the forward, would love to hear a little bit more about the specific marketing efforts you have planned to keep that momentum going into the back half of this fiscal year.

JOANNE C. CREVOISERAT: Thanks, Brooke. We continue to see strong customer acquisition across all of our brands. So the 3 million new customers across all of our brands, that's 8 -- 11 million new customers over the last 18 months. So we have been focused on a consumer/customer acquisition as part of our brand-building activities, again, structurally transformed our business to focus on improving our ability to engage consumers. And we see it paying off there.

We're doing that with innovative marketing. We're showing up on the platforms where our customers are. So first, it's getting to know and getting closer to our target consumers, knowing where they are and making sure we're speaking to them and connecting with them. These are customers who are transacting with us. So we -- these are customers who we've not only seen our marketing and our product, but they're buying from us and purchasing. So it's a combination of knowing our consumers, understanding and delivering great product that delivers on both their emotional and functional needs. So we're better embedding data in that side of the process. And then in marketing, we've been much more innovative in our marketing. We've connected with this test-and-learn process where we have cross-functional teams in the business ideating and testing consistently against hypothesis, but the things that work are being scaled. And that's how we're driving all of this traction with customer acquisition. And frankly, we're applying the same retention and repurchase rates and repeat rates and reactivation. So we can -- we are a data-rich company, over 90% direct-to-consumer. And we're leveraging that data using new tools and technology that we've invested in. Again, we continue to invest in talent that are driving both the creative side of the equation as well as the technical side to be in front of customers where they are and connect with them and speak to their values and the things that will be purchase drivers. So those are the drivers. The new customers that we're seeing are increasingly younger across our brands, and we think it provides a strong foundation for future growth.

TODD KAHN: And I could just add on the Coach side, the new customers we're seeing are -- we're seeing higher AURs from those new customers. And one of the things we've developed, which we're very proud of and I think gives us a lot of runway in this area of retention is the Coach Insider program. We have seen that our Insiders transact 20% more frequently as compared to nonmembers, and their baskets are higher. So we see that across both our retail and our value channel.

So we're excited about this. And what's really unique to the Coach Insider program, it's not a discount program. It's about early access. It's about being truly an insider, and that's what the customer is so engaged with. We've heard stories from our clients about, their being featured on the insider program and how much joy and pleasure they get out of that. So you'll see us continue to develop these programs and the benefits of being a Coach Insider to again create that connectivity with our customer in a much deeper and profounder way than just transacting.

OPERATOR: The next question comes from Paul Lejuez with Citi.

TRACY JILL KOGAN, VP, CITIGROUP INC., RESEARCH DIVISION: It's Tracy Kogan filling in for Paul. I was wondering if you could talk about your factory outlet strategy for Kate. How many stores do you guys have there currently? And what's your ultimate target? And I'm wondering if you have the same AUR strategy at the factory outlet channel for Kate as you do with Coach.

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JOANNE C. CREVOISERAT: Well, at Kate, we've seen tremendous traction. And we do have specialty and outlet stores. We're seeing traction across both. But the growth we're seeing has really been driven by our full price, and we are very excited about what we're seeing there. We expect to raise AUR, and we're seeing AUR growth across channels, but -- and we have a high digital penetration. So I think if you look at the Kate Spade business in aggregate, we see a compelling value in the marketplace, delivering great product. We see unique positioning in the market, and we see customers responding across channels. But our growth and the growth that we're seeing and the traction that we're seeing is increasingly in the specialty channel in retail, a lot of the engagement and the novelty that we're seeing across social media channels as well is driving that emotional connection to the Kate Spade consumer. So Kate Spade has a tremendous runway ahead for growth. We're seeing traction across channels, particularly in our specialty channel. And we're very confident and see a lot of opportunity for growth ahead, both in absolute and in AUR.

OPERATOR: Thank you. That concludes our Q&A. I would now like to turn the program back to Joanne Crevoiserat for any additional or closing remarks.

JOANNE C. CREVOISERAT: Well, I thank you all for joining us this morning. Through our acceleration program, we've radically transformed our business model, and it's delivering. We drove record sales and adjusted earnings during the holiday quarter with outperformance across each brand. We've increased our outlook for the year, which includes raising fiscal '22 or '22 revenue outlook to a record at \$6.75 billion with Coach approaching \$5 billion, an inflection at Kate Spade, digital revenue reaching \$2 billion, and our fiscal '22 outlook that is 40% above prepandemic levels.

These results also support our strong returns. We expect to return over \$1.5 billion to shareholders this year. And our teams are powering these results. They are our competitive advantage, and I want to recognize and thank them for the standout performance. Their relentless drive and unwavering focus on the consumer will build on our strong foundation and deliver sustainable growth into the future. Thank you.

OPERATOR: This does conclude today's program. Thank you for your participation. You may disconnect at any time.

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